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THE INDUSTRIAL SECTOR CONFIDENTLY DECLARES: "PLENTY OF RUNWAY LEFT"

RCM-SIOR Industrial Sentiment Report Summary

By Michael Millar

One of the most colorful ways to characterize and gauge the strength and longevity of real estate markets - including the national industrial market - has been to acknowledge how much runway is left. For the second time in as many years, participants in the Real Capital Markets (RCM)-Society of Industrial an Office Realtors (SIOR) Industrial Sentiment Report have declared, "there is still plenty of runway left."

Based on survey results and follow up interviews with brokers, investors and SIOR presidents (past, present, and future), the market today is strong, driven by the powerful one-two punch of a robust economy and the ongoing expansion of e-commerce. The robust nature of the industrial market bodes well for the future, with investors especially keen on "last mile" facilities to reach demographically-rich areas.

There are plenty of reasons to believe the runway could last anywhere from 24 to 30 months or more. At the same time, experts in industrial real estate are not blind to a variety of issues - including interest rates, an increasing shortage of quality assets for acquisition, tariffs and trade wars, and other geo-political matters - that could quickly shorten that runway.

The following are some highlights from the RCM-SIOR Industrial Investor Sentiment Report that depict the reasons for optimism as well as the issues that are causing concern.

OPTIMISM BUILDS THE LONG RUNWAY

In both the 2017 and 2018, RCM-SIOR Investor Sentiment reports that the perceptions of tracked participants' views on investment activity, pricing and cap rates are generally optimistic. While there may have been a slight tempering of enthusiasm year-over-year, the general sentiment is that the market remains on solid footing.

• Activity - More than 48 percent now suggest that activity will at the very least remain at or about the current level. One year ago, the figure was 43 percent.

• Industrial Pricing - More than 38 percent of respondents in 2018 anticipate pricing increases of five percent or more; in 2017 that number was 34 percent.

• Cap Rates - In 2018, 44 percent believe cap rates could go higher compared to 35 percent in 2017; 18 percent now see the potential for further compression versus 17 percent in 2017.

E-COMMERCE AND THE ECONOMY ARE A POWERFUL AND IMPACTFUL ONE-TWO PUNCH

Sustained growth in e-commerce and the general state of the economy have been a powerful one-two punch for the industrial sector over the last two years, as consistently noted by more than 70 percent of participants surveyed for the report.

The only real difference over the last two years is which punch comes first. In 2018, industrial professionals said the hardest punches came from the overall strength of the economy. That's a reversal from 2017 when e-commerce was identified as the lead punch. Regardless of whether e-commerce is the lead or follow-up punch, its impact cannot be understated. Some market projections show e-commerce growing at a rate that translates to demand for approximately 180 million square feet of logistics space by 2020.

LAST MILE IS FIRST FOR EMERGING AND EXPANDING OPPORTUNITIES

The strength of e-commerce helps to explain why market experts view last mile/in-fill development product as the most prominent, highly-sought after opportunities. The bottom line is that users want to be as close as they can to

population centers to provide same day, next day, or later in the day deliveries. Businesses across the country are adapting an Amazon-like strategy - a trend that is good for the industrial sector. Accordingly, an overwhelming majority of respondents (52 percent) confirmed their bullishness on last mile and in-fill development opportunities.

CAN'T OVERLOOK INTEREST RATES, TARIFFS, AND AVAILABILITY OF QUALITY PRODUCT AS THREATS

While there is continued optimism for the industrial sector, experts in the field are realistic that there are market forces and looming events, nationally and internationally, that pose a certain level of threat to the sector's ongoing performance.

Interest rates were cited by more than 34 percent of participant as the greatest potential threat, though many characterize that threat as more long-term than immediate. Like most other sectors, those in industrial real estate are watching the moves of the Fed, believing that the periodic increases are relatively easy to overcome. Yet many believe that a 100 to 125 basis point increase in the next year could be problematic.

Increasingly, given the current political environment, tariffs and trade wars are looming large on the minds of those in the industrial sector. More than 28 percent of survey participants believe the greatest threat could in fact come from ongoing trade wars and tariffs, which impact the general economy as well as real estate construction costs. The general consensus is that the economy can likely withstand a 10 percent tariff, but the impact of that going to 25 percent is another question.

The greatest issue associated with tariffs and trade wars is the uncertainty that it creates. Most companies, regardless of size, dislike uncertainty as it can create an inability to plan with a level of confidence that is required to make well-informed decisions.

One other area of concern of many investors, on par with the concerns about interest rates, is that the ongoing appetite for industrial real estate is depleting the supply of quality assets for acquisition. The consistently strong level of acquisition activity is likely to contribute to the view that prices will continue to increase, and that investors will continue to expand their acquisition criteria to satisfy their demand for industrial investments.

NO STOPPING US NOW

All that is good about the industrial marketplace as well as the factors that influence it - good equilibrium between supply and demand, the prospect for stable and healthy activity levels, the strength of the economy, and ever-expanding e-commerce - continue to make the U.S. the safest place to put capital, for domestic and international investors alike. Given this performance consistency and in spite of threats that do exist, there is every reason to believe there is plenty of runway left.